Supreme Court of the United States

OCTOBER TERM, 1965

No. 645

UNITED STATES,

Petitioner,

vs.

THE EQUITABLE LIFE ASSURANCE SOCIETY OF THE UNITED STATES,

Respondent.

On Writ of Certiorari to the Supreme Court of the State of New Jersey

BRIEF AND APPENDIX FOR RESPONDENTS

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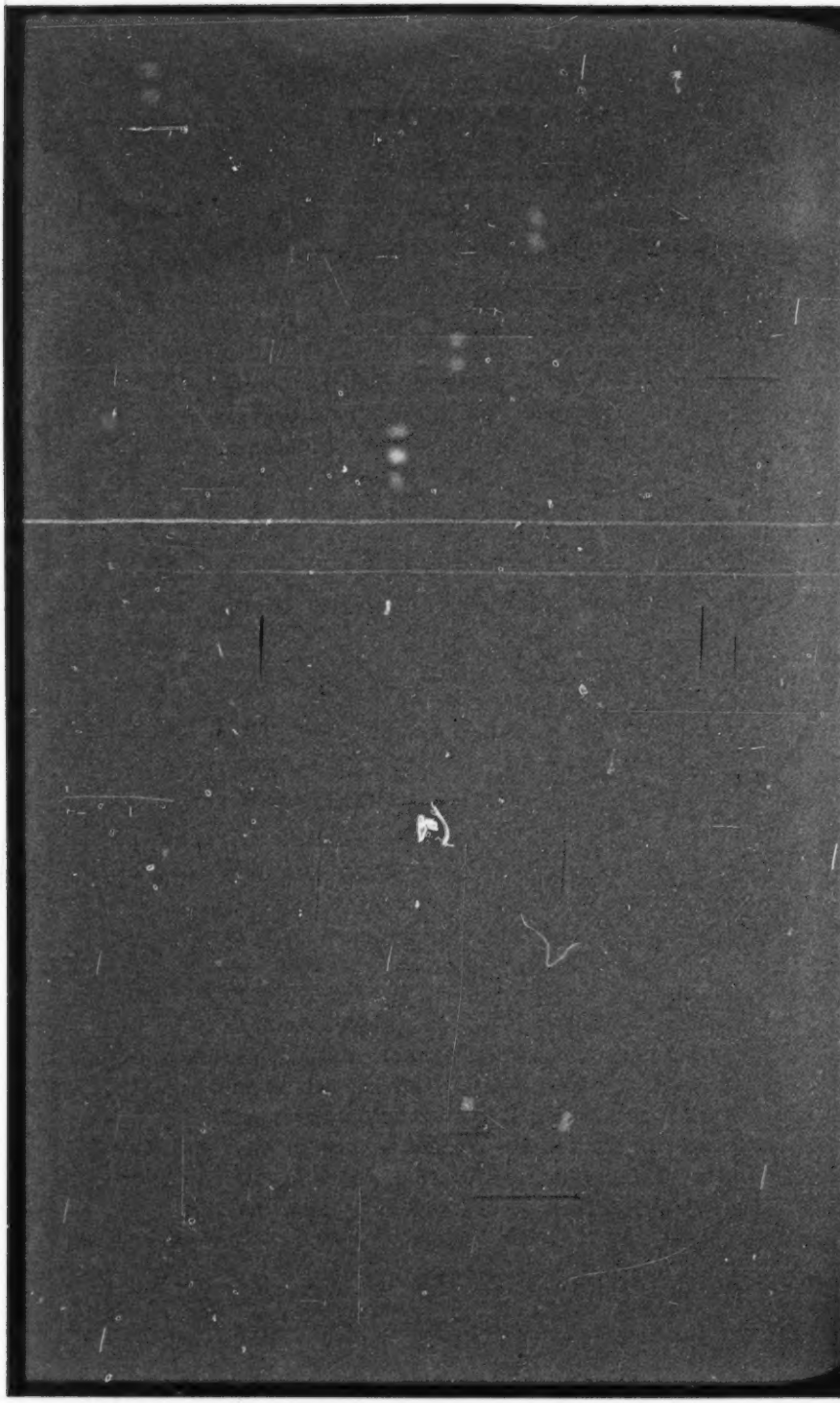

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BRIEF FOR RESPONDENTS

Counter-Statement of Questions Presented

The specific question raised in this case is whether a foreclosing mortgagee in New Jersey is entitled to receive out of the proceeds of sale of the mortgaged premises the amount of the counsel fee allowed under R.R. 4:55-7 (c) before payment is made to the United States on account of

a tax lien that was recorded more than two years after the mortgage and about one year before the default that resulted in the foreclosure action and sale. Although this specific question appears at first blush to be very narrow, the ramifications that are involved in the reasoning that the court chooses to apply in reaching its decision lead to the *real question* that is involved, viz.:

> What is the scope of the protection that Congress has given to mortgagees when the statutory provision of 26 U. S. C. §6323 (a) that a federal tax lien "shall not be valid as against any mortgagee * * * until notice thereof has been filed" is interpreted in the light of the "choateness rule" created by this court.

Summary of Argument

Mortgagees are presently being denied the protection Congress intended to give them in 1913, because this court has not defined the "choateness rule" as it applies to mortgagees. Since the advent of the "choateness rule" into the field of non-insolvency cases, every mortgage foreclosure action known to respondents that involves a federal tax lien becomes a contested action, in which the United States "disputes the priority of counsel fees and of any advances whatsoever made after the assessment dates of the lien of the United States."

Mortgagees can be relieved of this burden of contested foreclosure actions, and can again receive the protection Congress intended them to have, if this court will decide the choateness of the counsel fee in New Jersey foreclosure actions upon the basis of a principle that can be applied to every right held by a mortgagee, stated in such clear terms that reasonable men cannot differ as to the result.

Respondents suggest the following definition:

> If the amount of the item in question can be determined at the moment the notice of federal tax lien is filed, without making any assumptions other than (1) a date to which interest is to be computed, and (2) that if the mortgagor had defaulted, his default was in payment of the item in question, that item constitutes a "choate lien" and is entitled to priority over the federal tax lien, it being immaterial whether or not the mortgagor has actually defaulted.

ARGUMENT

POINT I

Mortgagees are presently denied the protection Congress intended to give them because this Court has yet to define the "choateness rule" as it applies to a mortgagee.

Respondents recognize, as did the Supreme Court of New Jersey, that the effect of a lien in relation to a provision of federal law for the collection of debts owing to the United States is always a federal question, to be decided ultimately by the Supreme Court of the United States. Of the many cases decided by this court in the broad field of competition between state-created liens and federal tax liens, however, none has involved a situation comparable to that in the present case. The efforts of the petitioner to bring this case within the scope of the decisions in *United States* v. *Pioneer American Ins Co.*[1] and

[1] 374 U. S. 84, 10 L. Ed. 2d 770, 83 S. Ct. 1651 (1963).

United States v. *Buffalo Savings Bank*,[2] if successful, would produce a holding either that could not be applied uniformly or that would almost completely emasculate the protection given to mortgagees by Congress in 1913.

In order to focus attention upon the basic principles involved in this case, it will be helpful to assume that the competition is directly and solely between the foreclosing first mortgagee and the United States. The second mortgage, which was given by the mortgagors on the same date as the first mortgage, merely increases the size of the priority adjustment fund which the United States has conceded is to be distributed according to state law (RA2a).

Commencing in 1866, Congress has provided that if any person liable to pay any tax neglects or refuses to pay the same after demand, the amount, with certain additions, "shall be a lien in favor of the United States upon all property, whether real or personal, belonging to such person."[3] In 1893 this court determined that this tax lien, though secret, was good even against a purchaser for value without notice.[4] However, Congress changed the law as to mortgagees, purchasers, and judgment creditors in 1913, and as to pledgees in 1939. With respect to mortgagees, it provided that this tax lien "shall not be valid as against any mortgagee * * * until notice thereof has been filed by the Secretary or his delegate."[5] It is this provision that

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[2] 371 U. S. 228, 9 L. Ed. 2d 283, 83 S. Ct. 314 (1963).

[3] July 13, 1866, c. 184, §9, 14 Stat. 107; R.S. §3186(a); I. R. C. 1939, §3670; I. R. C., 1954, §6321, 26 U. S. C. §6321.

[4] *United States* v. *Snyder*, 149 U. S. 210, 37 L. Ed. 705, 13 S. Ct. 846 (1893).

[5] R.S. §3186 (b); I. R. C., 1939, §3672; I. R. C., 1954 §6323; 26 U. S. C. §6323.

nust be interpreted and delimited in the present case.

The Congressional acts have not spelled out the details of the protection intended to be given to a mortgagee, and here has always been doubt concerning the priority of a federal tax lien in relation to any item involved in the lien held by a mortgagee that the United States has chosen to contest.

This court began to bring some order into the general field of competition between state-created liens and federal tax liens when, in 1950, it first applied the "choateness rule" to a non-insolvency case.[6] Unfortunately, this single event marked the end of the protection which Congress intended to give to mortgagees, for now every mortgage foreclosure action that involves a federal lien, whether it be for taxes or for a lien such as a mortgage, becomes a contested action, in which the United States picks certain items and disputes their priority. In most cases the mortgagees have capitulated, because of the expenses involved in an appeal on which this court is the final arbiter.

The reason for this unfortunate state of affairs was well stated by the Supreme Court of New Jersey in its opinion in this case: "The contours of the Supreme Court's doctrine of choateness remain to be fixed and undoubtedly further pronouncements by that Court will be handed down." (Tr. 19).

Until this court has clearly defined the "choateness rule" as it applies to a mortgagee, however, the mortgagee is utterly helpless because the United States, as indicated in its brief in this case, selects certain items to contest,

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[6] *United States v. Security Trust and Savings Bank*, 340 U. S. 47, 95 L. Ed. 53, 71 S. Ct. 111 (1950).

without considering the underlying principles involved.[7] Under such circumstances, the mortgagee is not protected, as Congress intended, but is continually subjected to contested foreclosure actions with no reasonable hope for relief other than imploring this court to decide this case on the basis of the principles involved, so that the minds of reasonable men can no longer differ when the "choateness rule" is applied to any element of a mortgage lien.[8]

Before an acceptable statement of the "choateness rule" as applied to a mortgagee can be formulated, however, it is necessary to examine and define two things, *viz.*, the "cho-

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[7] Throughout its brief, the United States gives evidence of the predicament of mortgagees in recent years. "The United States has not acquiesced in the subordination of federal tax liens to potentially substantial allowances for the counsel fees of adverse parties" (Pb5). "The United States conceded at the outset that the claims for principal and interest under the mortgages had priority over the tax lien" (Pb7). "The fact that the United States has not contested the allowance of costs, not including counsel fees, to senior lienors can hardly constitute a concession with respect to the present claim. Because in the usual foreclosure proceeding, taxable costs are *de minimis*, fixed in amount, and generally constitute reimbursement for sums paid over to State officials, the United States has not challenged their award" (Pb13). "The United States has not consented, and is certainly not obliged to consent, to the subordination of prior federal liens to potentially substantial claims for attorney's fees" (Pb14).

[8] For years mortgagees, as well as other lienholders, such as mechanic's lien claimants who are not protected by the 1913 Congressional act, have sought relief in the Congress. Unfortunately, the Congress moves slowly and cautiously in such matters. Note that it took 20 years after this court had decided the *Snyder* case until Congress acted to protect mortgagees, purchasers, and judgment creditors, and 46 years until it acted to protect pledgees.

ateness rule", and the rights of the mortgagee. They will be examined in that order.

A. The "Choateness Rule"

The "choateness rule" was formulated in a line of cases involving situations in which the taxpayer was insolvent. Since before 1800 Congress has provided that in such circumstances "the debts due to the United States shall be first satisfied."[9] Although none of the statutes embodying this provision has contained any exceptions, language used in some of the earliest cases has resulted in many efforts to have this court declare that an exception does exist in the case of a competing lien that was "fully perfected and specific" prior to the insolvency. However, the court has never found it necessary to determine whether the exception actually does exist, because it has never decided a case in which the competing lien was found to be "fully perfected and specific prior to the insolvency." None of the decisions has involved competition between a federal tax lien and a mortgage on real property. Therefore, this line of cases is not at all helpful in determining the scope of the protection which Congress has given to mortgagees since 1913.

Furthermore, in *United States* v. *Vermont*,[10] this court rejected the contention of the United States "that federal tax liens are entitled to priority * * * over any antecedent lien which is not sufficiently perfected to prevail against the explicit priority which R.S. §3466 gives to claims of

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[9] March 3, 1797, c. 20, §5; 1 Stat. 515; R. S. §3466; 31 U. S. C. §191.

[10] 377 U. S. 351, 12 L. Ed. 2d 370, 84 S. Ct. 1267 (1964).

the United States in situations involving insolvency."[11] The Court stated that the *New Britain* case, which did not involve an insolvency situation, "makes quite clear that different standards apply where the United States' claim is based on a tax lien arising under §§6321 and 6322",[12] and that the argument of the United States "fails to discriminate between the standards applicable under the federal tax lien provisions and those applicable to an insolvent debtor under R.S. §3466." [11] [13]

The first tax lien case in which this court applied the "choateness rule" was *United States* v. *Security Trust and Savings Bank*, decided in 1950.[14] The case involved competition between a California attachment lien and three federal tax liens, notices of which were filed about two months after the attachment and about four months before judgment was entered in the attachment action. The attachment lien was held to be contingent or inchoate under both state and federal law.

The same result was reached in *United States* v. *Acri*,[15] even though under state law an Ohio attachment lien is deemed to be perfected at the time of the attachment, and in *United States* v. *Liverpool & London & Globe Ins. Co.*,[16] which involved garnishment of insurance proceeds.

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[11] 377 U. S. at 356; 12 L. Ed 2d at 374.

[12] 377 U. S. at 358; 12 L. Ed. 2d at 375.

[13] Hereafter when reference is made to "tax lien cases", the cases do not involve an insolvent taxpayer. The phrase "tax lien cases" is used to distinguish such cases from "insolvency cases."

[14] 340 U. S. 47, 95 L. Ed. 53, 71 S. Ct. 111 (1950).

[15] 348 U. S. 211, 99 L. Ed. 264, 75 S. Ct. 239 (1955).

[16] 348 U. S. 215, 99 L. Ed. 268, 75 S. Ct. 247 (1955).

From the standpoint of the present case, the most significant fact involved in these attachment and garnishment cases is that the lien in competition with the federal tax lien was not held by a "mortgagee, pledgee, purchaser, or judgment creditor", and thus there was no Congressional act giving such liens priority over unrecorded federal tax liens. Justice Jackson, concurring in the *Security Trust* case, stated that: "The history of this tax lien statute indicates that only a judgment creditor in the conventional sense is protected";[17] and, with two justices dissenting, the court adopted this statement in *United States* v. *Gilbert Associates*.[18] [19] In that case, the New Hampshire Supreme Court had stated that "It is settled by our decisions that the assessment of a tax is in the nature of a judgment, enforced by a warrant instead of an execution."[20] This court held, however, that "Congress used the words 'judgment creditor' in §3672 in the usual, conventional sense of a judgment of a court of record".[21]

In succeeding cases, this court has developed the principle of these cases into a very important guidepost. Thus, in

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[17] 340 U. S. at 52; 95 L. Ed. at 57.

[18] 345 U. S. 361, 97 L. Ed. 1071, 73 S. Ct. 701 (1953).

[19] Although the taxpayer in *Gilbert Associates* was insolvent, this court first considered the status of the municipality as "a judgment creditor within the meaning of §3672". After rejecting the claim of the municipality on this ground, the court went on to consider and reject its claim as the holder of a general lien on all the taxpayer's property, the decision on this point being based upon the priority given to the United States when the taxpayer is insolvent, at least where the state-created lien is not "a perfected and specific lien."

[20] 345 U. S. at 363, 97 L. Ed. at 1075.

[21] 345 U. S. at 364, 97 L. Ed. at 1075.

United States v. *Scovil*,[22] which involved a landlord's distress for rent that was commenced after several federal tax liens had arisen, but before notice of the tax liens had been filed, the court held that the landlord obviously was not a purchaser, stating that: "A purchaser within the meaning of §3672 usually means one who acquires title for a valuable consideration in the manner of vendor and vendee".[23] It also held that the United States must prevail on its tax liens because: "The landlord had a lien other than a mortgage, pledge, or judgment lien. As to all other liens, such as the distress lien in the instant case, §3672 of the Internal Revenue Code affords no protection."[23] In *United States* v. *New Britain*,[24] which is discussed hereafter, the court stated that: "There is nothing in the language of §3672 to show that Congress intended antecedent federal tax liens to rank behind any but the specific categories of interests set out therein, and the legislative history lends support to this impression."[25]

The full significance of these holdings in *Security Trust*, *Gilbert Associates*, *Scovil*, and *New Britain*, is brought out in *United States* v. *White Bear Brewing Co.*,[26] which is one of a series of four cases involving mechanic's liens, each of which resulted in a *per curiam* reversal by this court of decisions which had given priority to the mechanic's lien. In the other three cases, even though the mechanic's liens had arisen under the applicable state statutes prior to the

[22] 348 U. S. 218, 99 L. Ed. 271, 75 S. Ct. 244 (1955).

[23] 348 U. S. at 220, 99 L. Ed. at 274.

[24] 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367 (1954).

[25] 347 U. S. at 88, 98 L. Ed. at 527.

[26] 350 U. S. 1010, 100 L. Ed. 871, 76 S. Ct. 646 (1956).

filing of the notices of federal tax liens, the actions to enforce the state-created liens were not commenced until after the federal notices had been filed. In *White Bear*, however, two justices dissented on the ground that "the mechanic's lien was specific, prior in time, perfected in the sense that everything possible under state law had been done to make it choate, and was being enforced before the federal tax lien arose. * * * The contract had been performed, the mechanic's lien recorded for a specific amount, and suit instituted to enforce the lien—all before the federal taxes were assessed and the tax liens recorded. Moreover, by the time the United States filed the present action to foreclose its tax liens, the mechanic's lien had been reduced to judgment, and the real estate sold at public auction and transferred by the purchaser to others."[27]

Interpreting the result of the *White Bear* case in the light of the prior holdings of this court, we find that Congress had provided no protection from a federal tax lien to any lien claimant who is not a mortgagee, pledgee, purchaser, or judgment creditor. Therefore, in order for a lien claimant such as the holder of a mechanic's lien to prevail over a federal tax lien, it is necessary for the lien claimant to have achieved the status of a judgment creditor "in the usual, conventional sense of a judgment of a court of record," prior to the time notice of the federal lien is recorded.

Further guideposts are found in *United States* v. *New Britain*, *supra*,[28] and *United States* v. *Buffalo Savings Bank*.[29] The principal contributions of *New Britain* are its definition of a "choate lien" as one in which "the identity

[27] 350 U. S. at 1010, 100 L. Ed. at 871.

[28] 347 U. S. 81, 98 L. Ed. 520, 74 S. Ct. 367 (1954).

[29] 371 U. S. 228, 9 L. Ed. 2d 283, 83 S. Ct. 314 (1963).

of the lienor, the property subject to the lien, and the amount of the lien are established"[30] and its statement that the priority of a lien created by state law in relation to a federal tax lien "must depend on the time it attached to the property in question and became choate".[31] In any discussion of *New Britain*, it is important to bear in mind that the dispute was between the United States with its tax liens and the City of New Britain with its liens for delinquent real estate taxes and water rents. The dispute involved surplus moneys in a mortgage foreclosure action, after the two mortgages held by the plaintiff had been paid in full, together with all expenses of sale, including attorney's fees for the foreclosure action. The holding was that the municipal tax liens, even though given priority over the mortgages by state law, were not entitled to priority over the federal tax liens unless they had attached to the property and become choate prior to the time at which the federal tax liens arose.[32] As noted above, the court had previously determined in *United States* v. *Gilbert Associates*,[33] that Congress had provided no priority for municipal tax liens that attach after federal tax liens have arisen unless the municipality has achieved

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[30] 347 U. S. at 84, 98 L. Ed. at 525.

[31] 347 U. S. at 86, 98 L. Ed at 526.

[32] It appears that the federal tax liens arose after some of the municipal liens had attached to the property and become choate but before other municipal liens had attached and become choate. The ultimate distribution on remand did not make a distinction, however, because the United States was paid in full and the City received the other available funds and also the balance due to it at the expense of a judgment creditor, pursuant to state law. *Brown* v. *General Laundry Service, Inc.*, 19 Conn. Sup. 335, 113 A. 2d 601 (Super. Ct. 1955).

[33] 345 U. S. 361, 97 L. Ed. 1071, 73 S. Ct. 701 (1953).

the status of a "judgment creditor" prior to the time that notice of the federal tax liens is filed.[34] The court specifically bypassed the question of whether the mortgagee could have advanced the delinquent taxes and water rents pursuant to the terms of the mortgage and claimed priority for these advances as part of the mortgage, because the mortgagee had not made any such advancements.[35] Thus, there is nothing in *New Britain* other than the definition of choateness that helps us determine the scope of the protection which Congress afforded to mortgagees as to any portion of its mortgage lien that, from the inception of the mortgage, is an integral part of the lien.

Buffalo Savings Bank[36] also involved delinquent real estate taxes and delinquent sewer and water rents, all of which accrued after notice of a federal tax lien had been filed. The New York Court of Appeals,[37] with two judges dissenting, had held that the foreclosing mortgagee and the municipality had liens which "attached directly to the particular parcel of real property" while the federal lien arose "because of an unconnected indebtedness of the owner of

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[34] In *New Britain*, the court distinguishes *Gilbert Associates* on the ground that "the question we have here did not arise there because that was a case involving personal property and insolvency of the taxpayer". (347 U. S. at 87, 98 L. Ed. at 526). The remark does not detract from the first holding in *Gilbert Associates* that the municipality could only be a judgment creditor under §3672 if it were a judgment creditor "in the usual, conventional sense of a judgment of a court of record." (345 U. S. at 364, 97 L. Ed. at 1075).

[35] 347 U. S. at 87, 98 L. Ed. at 527.

[36] 371 U. S. 228, 9 L. Ed. 2d 283, 83 S. Ct. 314 (1963).

[37] *Buffalo Savings Bank* v. *Victory*, 11 N. Y. 2d 31, 226 N. Y. S. 2d 382, 181 N. E. 2d 413 (1962).

the land" and was filed "against a presumed equity in the real property held by the mortgagor" which would have substance only if a sale of the property should produce a surplus after payment of all liens such as the mortgage and the tax, sewer and water liens for essential services, in which "the property itself, in its very nature as land, incurs the indebtedness".[38] Based upon this property concept,[39] the state court decreed that the delinquent real estate taxes and sewer and water rents should be paid, pursuant to state law and practice, "out of the proceeds of the sale as expenses of the sale", with the federal tax lien attaching to any surplus.[40]

With one dissent, this court reversed the state court, commenting that "the state may not avoid the priority rules of the federal tax lien by the formalistic device of characterizing subsequently accruing local liens as expenses of sale".[41]

The decision in *Buffalo Savings Bank* is consistent with that in *New Britain,* in which the court, while giving priority to municipal liens that had accrued prior to the time the federal tax liens had arisen, refused to give priority to the municipal liens that accrued thereafter. As in *New Britain,* the court was not called upon to consider what the result

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[38] 11 N. Y. 2d at 38 and 39, 226 N. Y. S. 2d at 387.

[39] In the discussion of mortgages which follows, it will be apparent that the property concept was properly rejected by this court, and respondents in the present case make no such claim.

[40] 11 N. Y. 2d at 43, 226 N. Y. S. 2d at 391.

[41] 371 U. S. at 229, 9 L. Ed. 2d at 284.

would have been if the mortgagee had advanced the municipal taxes, sewer rents, and water rents pursuant to the terms of the mortgage, with the amount so advanced becoming part of the mortgage debt covered by the mortgage. Since the state-created liens in question were not in existence at the time the notices of federal tax liens were filed, and hence were clearly inchoate by federal standards, *Buffalo Savings Bank* establishes only that the state cannot transform these inchoate liens into choate liens by making them a part of the expenses of sale and, in effect, a part of the mortgage lien. Municipal tax liens are not a part of a mortgage lien unless the mortgagee has advanced money pursuant to the terms of the mortgage to pay the taxes, and whether or not the amounts of its advancements will be choate or inchoate liens depends upon whether the municipal taxes being paid are choate or inchoate. The decision in *Buffalo Savings Bank* does not apply to items which are integral parts of the original mortgage lien.

Finally, in *United States* v. *Pioneer American Insurance Company*[42] this court rejected the "contention that the choateness rule has no place when a mortgage under §6323 (a) is involved",[43] stating that "we believe Congress intended that if out of the whole spectrum of state-created liens, certain liens are to enjoy the preferred status granted by §6323, they should at least have attained the degree of perfection required of other liens and be choate for the purposes of the federal rule. The Court has never held that mortgagees face a less demanding test of perfection than other interests when competing with the federal lien."[43] [44]

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[42] 374 U. S. 84, 10 L. Ed. 2d 770, 83 S. Ct. 1651 (1963).

[43] 374 U. S. at 89, 10 L. Ed. 2d at 775.

[44] The holding of the court that the reasonable counsel fee in *Pioneer* was inchoate will be discussed later in the brief.

B. The Rights of the Mortgagee

A mortgagee is defined as a person to whom property is mortgaged, while a mortgage is a conveyance of property as security for the payment of a debt.[45] A security is "an instrument which renders certain the performance of a contract".[46]

The first thing to be noted about a mortgage, then, is that it is needed only if there is a default in the performance of some other contract. In the usual case involving land, it renders certain the performance of a borrower under the terms of a bond or a note. So long as the borrower lives up to his obligations on the bond or the note, the mortgage is of no benefit to the mortgagee. His rights under the mortgage become meaningful only if and when the borrower, or mortgagor, defaults in his obligations under the bond or note.

The history of mortgages, which are of very ancient origin,[47] shows that the rights of the mortgagee, in the event of a default by the mortgagor in his principal obligation, have varied from time to time.

The common law conception of a mortgage was a conveyance of the legal title upon condition in the nature of a defeasance, *i.e.*, the payment of the debt on the very day stipulated. In default of strict compliance with the condition, the conveyance *ipso facto* became absolute and the mortgagee's

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[45] Webster's New Collegiate Dictionary (2d ed., 1953) 549.

[46] Bouvier's Law Dictionary (Baldwin's Century Edition, 1929) 1098.

[47] The Bible speaks of persons who mortgaged their lands, vineyards and houses to buy grain because of a famine and to pay the king's taxes. *Nehemiah* V. 3, 4.

estate ripened into an indefeasible legal title in consonance with the terms of the conveyance.[48]

Equity very early took jurisdiction to grant relief from such forfeitures if it could find equitable grounds, for example, where payment had been prevented by the mortgagee or by accident. By the year 1625, equity considered that the real nature of a mortgage transaction was a debt (the principal obligation) and it took jurisdiction to decree that the forfeiture of the land could be relieved by the *payment of the debt, with interest, expenses, and costs,* without considering the reason for the default. This redeemable interest was designated as the equity of redemption, since it could be enforced only in the courts of equity, and this equity developed into an estate in land which could be devised, granted, or entailed.[49]

Having provided protection to the mortgagee through the equity of redemption, it was found to be necessary to provide some protection for the mortgagee, because it was deemed unreasonable to permit the mortgagor, or one holding under or through him, to come in to redeem at any time. Thus, in about 1629, the Court of Chancery enabled the mortgagee to file a bill for an account and to obtain a decree that the mortgagor or those claiming under or through him pay *the sum due, with interest and costs,* within a reasonable time, or be foreclosed of the equity of redemption. This procedure, known in this country as strict fore-

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[48] *Sears, Roebuck & Co. v. Camp*, 124 N. J. Eq. 403, 407, 1 A. 2d 425, 427 (E. & A. 1938).

[49] It is this concept of the equity of redemption as an estate in land that forms the basis of the rejection of the property concept relied upon by the New York Court of Appeals in *Buffalo Savings Bank*.

closure, was the usual practice in New Jersey in colonial days, and was available as a means of cutting off the equity of redemption of mortgagors until 1880.

Many courts felt that strict foreclosure was too severe, however, in that the equity of redemption might be barred even though the value of the property was in excess of the mortgage debt, and because of the general acceptance of the theory that the mortgagee does not obtain a "conveyance of the legal title upon condition in the nature of a defeasance", but rather a lien upon the property, i.e., a security interest therein. Either with or without statutory authority, courts began to order judicial sales of the property, rather than strict foreclosure, and today in this country foreclosure by sale is employed almost universally, although in a few states strict foreclosure or powers of sale contained in the mortgages are still recognized.

The first statute relating to sale of the mortgaged premises in New Jersey appeared in 1772. It provided for service of process by publication on absconding mortgagors, or on mortgagors who refused to appear. Upon the expiration of the time limited by the order, and proof of publication and posting, a decree *pro confesso* might be entered and a sale by the sheriff ordered. The statute, which was probably copied from a New York statute of 1760, was reenacted several times, but has existed in its present form, with only minor amendments, since 1873. Although strict foreclosure existed as an alternative remedy in the early days, the courts did not hesitate to order a sale under their inherent equity jurisdiction, especially in the case of infants; and long before 1880, when foreclosure by execution

sale became mandatory in New Jersey, it was the customary form of relief granted to the mortgagee.[50]

Thus, in 1913, when Congress provided that a federal tax lien should be invalid as to any mortgagee until notice is filed, it must have been aware that a mortgagee in New Jersey, and in most other states, had no right to take any action under its mortgage unless and until the mortgagor defaulted in his obligations to repay the indebtedness secured by the mortgage. It must also have been aware that the only way in which the mortgagor could avoid foreclosure of his equity of redemption, from the time the equity of redemption was first created by the English courts of chancery, was to pay the *sum due, with interests and costs.* It must also have been aware that a mortgage is made up of several parts—principal, interest, additional advances of principal, advances to pay delinquent taxes, advances to pay delinquent insurance premiums, advances to make necessary repairs, and the costs involved in realizing these sums out of the mortgaged property. These costs include: the cost of searches needed to determine the parties affected by a foreclosure action; filing fees for complaint and notice of *lis pendens;* sheriffs fees and/or publication fees for making service; advertising fees in connection with the sheriff's sale; sheriff's disbursements for conducting the sale and conveying the property to the purchaser; sheriff's commissions on the sale; and the fees of the attorney who conducts the foreclosure action.

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[50] Tischler, *Strict Foreclosure in New Jersey*, 64 N. J. L. J. 141, 145 & 146 (3-27-41). The article, written by one of New Jersey's leading lawyers and teachers in the field of real property, contains substantial citations of authorities for the propositions stated from footnote 48 to footnote 50.

Congress must be presumed, therefore, to have intended to protect each and every one of these elements of a mortgage when it made an unrecorded federal tax lien invalid as to *mortgagees*. This court has not declared anything different. It has merely stated that Congress intended to give priority over the federal tax lien only if the competing state-created lien meets the federal "choateness rule". We must turn, then, to an examination of the various elements of a mortgage lien in the light of this court's development of the "choateness rule" in the tax lien cases.

C. The "Choateness Rule" applied to the Rights of the Mortgagee

The United States includes several statements in Point I, A of its brief which it denominates "guidelines" to be applied in determining the priority of state-created liens and federal tax liens (Pb5-7). The difficulty, however, is that these co-called guidelines include such words as "liens", "prior, perfected liens", "inchoate liens", and "subsequently perfected liens", and the brief of the United States does not include a discussion of the principles to be applied in defining these terms. Instead, because a counsel fee was denied priority in *Pioneer*, the United States believes that all counsel fees must be denied priority, and that it is not necessary to define the "choateness rule" in relation to a mortgagee to any greater extent. It argues, citing *United States* v. *Speers*,[51] that there can be no "unequal application of the federal tax laws, depending upon variances in the terms and phraseology of different state and local * * * statutes and judicial rulings thereon" (Pb7). The fact is, however, that Congress provided for

[51] 382 U. S. 266, 15 L. Ed. 2d 314, 86 S. Ct. 411 (1965).

just such variation, when it declared that the federal tax lien should be invalid as to "mortgagees". A mortgagee today is a person who has a lien that is given to him as security for the repayment of a loan, which lien becomes enforceable out of the property subject to the lien if and when the mortgagor defaults; and it is well established *federal* law that "State law creates legal interests and rights." *Morgan* v. *C. I. R.*[32] There is nothing that requires a mortgagee in New Jersey to have the same interests and rights as a mortgagee in Arkansas. Therefore, to the extent that the interests and rights of a mortgagee in the one state vary from the interests and rights of a mortgagee in the other, the application of the "choateness rule" to competition between mortgage liens and federal tax liens may very well give rise to different results "depending upon variances in the terms and phraseology of different state and local * * * statutes and judicial rulings thereon"; and the counsel fee allowed in a New Jersey foreclosure action *can* be entitled to priority over a federal tax lien even though the counsel fee in Arkansas was not entitled to such priority. The result depends upon a clear understanding of the "choateness rule" and its proper application to each and every element of the lien of a mortgagee.

In Point II, B of appellant's brief, it is stated that "The United States conceded at the outset that the claims for the principal and interest under the mortgages had priority over the tax lien" (Pb7). Respondents are not willing to accept that concession in arguing this case, however, without a thorough investigation of the basis for the concession, to determine what there is about the principal and

[32] 309 U. S. 78, 80, 84 L. Ed. 585, 588, 60 S. Ct. 424 (1940).

interest due on the mortgage that entitles it to priority over a federal tax lien when the United States is unwilling to concede priority to other items involved in the lien of a mortgage.

At page 8 of its brief, the United States says: "It follows that when the tax lien arose, respondent had no claim for attorney's fees, let alone a perfected lien for one. That claim remained a purely speculative contingency at least until default and the commencement of foreclosure proceedings."

There are at least three objections to this statement:

1. It fails to distinguish between a "claim" and an "enforceable claim."
2. It does not accord with the true nature of a mortgage lien.
3. It does not give adequate consideration to the reasoning applied by this court in its prior decisions relating to choateness.

1. The "claim" of the mortgagee.

No mortgagee has *ever* had a "claim" for *anything* that could be enforced out of the property described in the mortgage prior to the time that the mortgagor defaults in his primary obligation to repay the loan that the mortgage was given to secure. This statement is as true with respect to the principal and interest secured by the mortgage as it is true with respect to the counsel fee, or any other costs, involved in the foreclosure action which the mortgagee *must* bring if he wishes to enforce his "claim" after default by the mortgagor.

Therefore, if a mortgagee must have an "enforceable claim" at the time a notice of federal tax lien is filed, the protection given to mortgagees by Congress is almost completely illusory. Protection would be limited to those few cases in which default has occurred at a time sufficiently in advance of the filing of the notice of federal tax lien to permit the mortgagee to call the loan, order and receive the necessary searches, and commence an action—all in the face of convincing a court of equity that he has not been overbearing. Congress cannot be deemed to have enacted such useless legislation.

2. *The true nature of the mortgage lien.*

The United States fails to distinguish between the *creation* of a lien and the *enforcement* of a lien. In the case of a mortgage, the lien is created at the time the loan is made. The lien cannot be *enforced*, however, until the mortgagor defaults in his primary obligation to repay the loan in accordance with the terms of the bond or note. As soon as the mortgage is given, however, it is known that if the mortgagor does default, the only way the mortgagee can enforce the lien is to commence a foreclosure action and carry it through to a sheriff's sale. Thus, the lien of the mortgage, from the very outset, consists of the mortgage principal; the interest due thereon from the date the loan is made to the date on which the proceeds of the sale are received by the sheriff; all additional advancements made by the mortgagee pursuant to the terms of the mortgage, with interest thereon from the dates of the advancements to the date on which the proceeds of the sale are received by the sheriff;and all costs involved in the enforcement of the lien, including search fees, court costs, attorney's fees, advertising costs, and sheriff's fees and

commissions.[53] None of these items can be considered to be inchoate on the ground that enforcement of the lien has not reached a certain point in the proceeding by the time a notice of federal lien has been filed without destroying the lien, because the lien is the right to obtain repayment of the loan out of the property subject to the lien, and the mortgagee is powerless to commence an action until the mortgagor has defaulted.

Default of the mortgagor, then, is the *sine qua non* of enforcement of the mortgage lien. It has no bearing whatever either upon creation of the lien or upon choateness of the lien.

All of the items listed above exist as a basic and integral part of the mortgage lien, as to which, in the absence of some defect in the lien,[54] Congress has accorded priority; and the determination of choateness must be made with a test other than default of the mortgagor.

3. *The reasoning applied by this court in its prior decisions relating to choateness.*

At the time Congress acted to protect the mortgagee in 1913, there was nothing in the legislative history or in the

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[53] The costs of enforcement would be nil if any of our fifty states recognized the common law mortgage. Prior to the founding of this country, however, the English Court of Chancery had abolished such mortgages as being too harsh.

The costs of enforcement would be lower in any of our states that recognize strict foreclosure or powers of sale in the mortgages. But our courts of equity or our legislatures, or both, have ruled out these procedures in most states, again on the ground that they are too harsh.

[54] Including inchoateness.

act itself to indicate that the rights of the mortgagee were dependent upon a finding that the mortgagee's rights amounted to a "choate lien". As we have seen, the concept of choateness of competing liens was first introduced into non-insolvency tax lien cases in 1950; and it was not until 1963, in *Pioneer*, that this court declared unequivocally that the "choateness rule" applies to mortgagees.

The definition of a choate lien was set forth in *New Britain* as follows:

> "The liens may also be perfected in the sense that there is nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established."[55]

The definition includes three items: identity of the lienor, the property subject to the lien, and the amount of the lien. The United States, however, seeks to add a fourth requirement "that there is nothing more to be done". Its arguments ignore the rest of the phrase "to have a choate lien".

As we have seen, in the case of a mortgage there is nothing that *can* be done until the mortgagor-taxpayer defaults, and so we can dismiss default of the mortgagors as a requirement.

The United States contends, however, that it is necessary for judgment to be entered in the foreclosure action in order for the mortgagee "to have a choate lien". But judgment is merely one intermediate step in the judicial process whereby the equity of redemption is foreclosed. The judg-

[55] 347 U. S. at 84, 98 L. Ed. at 525.

ment, at least in New Jersey, merely fixes, as of a given date, the amount of principal and interest due on the mortgage, and the amount of the counsel fee computed according to R.R. 4:55-7(c), and then orders a sale of the mortgaged premises to raise the amount stated to be due to the plaintiff, with interest and costs, including the counsel fee. It is as necessary for the court to determine the amount of principal due as it is for it to determine the amount of the counsel fee. And thereafter it is necessary for the clerk of the court to compute the taxed costs.

But even then, the mortgagee has not realized anything from his rights under the mortgage. He must obtain an execution, which commands the sheriff to sell the mortgaged property at public sale. The sheriff is required to advertise the sale of the property for an extended period, and to conduct the sale. The mortgagee must make a substantial deposit[56] on account of the sheriff's costs; and, if a sale is held, the sheriff is entitled to commissions of 4% on the first thousand dollars of the purchase price and 2½% on the excess, and the sheriff's fees and commissions are entitled to payment over all other items.[57] The sheriff cannot deliver the deed for ten days, during which period any person in interest can move to have the sale set aside if he has an equitable ground for objecting to the sale.[58] In the absence of any such objections, the equity of redemption is thus foreclosed only when there has been an

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[56] (Usually $300 for the respondent first mortgagee in this case).

[57] N.J.S. 22A:4-8.

[58] New Jersey no longer requires confirmation of judicial sales. Confirmation was required in New Jersey until 1948, and is still required in many states. Until confirmed, the mortgagor retains the right to redeem.

actual sale of the mortgaged premises conducted by the sheriff of the county in which the lands are located. Then, and only then, is the mortgagee able to realize the benefit of the rights given to him under the mortgage; and in the meantime he has had to bear the entire burden of the expenses of the action. Throughout this entire period, the mortgagee's rights are limited by the extent of his lien.

The United States fails to recognize this function of the lien. At page 8 of its brief, it cites R.R. 4:82-5 in footnote 7, and states that "a mortgagee who commences and then abandons a foreclosure action loses his claim to attorney's fees even though junior encumbrancers proceed with the action."

If the mortgagee abandons the foreclosure action, he not only loses his claim for attorney's fees, but also his claims for principal, interest, and costs. The reason is obvious. If the mortgagor makes payment to the foreclosing mortgagee, the mortgagee is no longer required to enforce his lien.

The mortgagee, then, can *never* be in the position of "having nothing more to be done" until a sheriff's sale has been completed and the time for objection has expired. If the matter has proceeded that far, however, the mortgagee's rights have been completely satisfied or extinguished, and no lien is involved. There is no intermediate step in the foreclosure proceeding that can be said to mark the point at which "there is nothing more to be done", or at which the lien has been "perfected" in the sense implied by the United States at page 8 of its brief. The conclusion must be that the key to the problem of priorities is found in the words "choate lien", and that the definition of that term does *not* include the concept of whether "there is nothing more to be done".

The decisions of this court make it clear that the "choateness rule" involves only three items. In the case of a mortgage of specific property, it really involves only one because, barring an intrinsic defect, the identity of the lienor and the property subject to the lien are set forth in the mortgage. *The entire case, then, is reduced to a determination of what this court believes Congress intended should be necessary to establish the amount of the lien of a mortgage that will have priority over a federal tax lien recorded after the mortgage has been given.*

The amount of principal to be enforced through the mortgage can never be predicted prior to actual default. So long as the mortgagor fulfills his primary obligations on the bond or note, the principal amount will be reduced by whatever payments of principal are made, whether made according to an amortization schedule, or according to a prepayment privilege granted by the mortgagee. Thus, unless the mortgagor-taxpayer has defaulted prior to the time notice of a federal tax lien has been filed, it is impossible to fix the amount of the lien for principal, except in terms of a maximum amount that will be entitled to priority.[59]

In terms of principal, however, the United States has refused to recognize that the maximum amount of mortgage principal entitled to priority over a federal tax lien is determined only when notice of the federal tax lien is filed. The answer of the United States filed in this action is identical with those filed in all such cases in the State of New Jersey known to respondents. That answer "disputes the

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[59] In *Pioneer*, the mortgagors had defaulted prior to the time the notices of federal tax liens had been filed, and so it was possible to say that the principal of the mortgage was definite in amount. (374 U. S. at 92; 10 L. Ed 2d at 776).

priority * * * of any advances whatsoever made after the assessment dates of the lien of the United States". (Tr. 4). Certainly when Congress declared federal tax liens invalid as to mortgagees until notice is filed, it recognized that the mortgagee needed the protection of notice whenever it should advance money, and it must have intended to include all items of principal that had been advanced by the mortgagee pursuant to the terms of the mortgage prior to the filing of the notice, whether the advance was made at the inception of the loan or at some future time prior to the filing of the notice of federal lien. Such later advancements are every bit as choate as the original advance made at the outset of the loan.

If the amount of principal to be obtained out of the property cannot be definitely fixed in amount prior to default by the mortgagor, the amount of interest is even more indefinite. In the case of interest, we cannot take the concurrence of an assumed default and filing of the notice of federal tax lien and then determine the amount of interest, for the interest will continue to accrue until the purchaser at the sheriff's sale has paid the full purchase price. No one can predict when such payment will be made until the very time at which delivery is made to the sheriff, and so we cannot even predict what the maximum amount of interest will be.[60] As we have seen, if the proceeding has

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[60] Even though in *Pioneer* the mortgagors had defaulted prior to the time the notices of federal tax liens had been filed, the amount of interest could not be definitely established until the date of payment became known. Thus, the statement in *Pioneer* that the interest of the mortgage was definite in amount would have been incorrect if the phrase required an absolute dollar and cents figure. (374 U. S. at 92, 10 L. Ed. 2d at 776).

reached the point of payment of the purchase price after a sheriff's sale, we are no longer talking about a mortgage, a lien, or competition with a federal tax lien.

In *New Britain*, this court said that Congress intended that the priority of a competing lien "must depend upon the time it attached to the property in question and became choate". Therefore, when the United States concedes that the principal and interest secured by a mortgage have priority over the tax lien, it is conceding that these items meet the "choateness rule" established by this court, despite the fact that there is no time after the inception of the mortgage at which the exact amount of the lien that will be paid out of the property can be determined. The original principal amount and the rate of interest are known, from which computations can be made, but even the maximum amount of the lien cannot be determined until the proceeds of sale are received by the sheriff. Despite these elements of uncertainty, the government is correct in conceding, in effect, that the principal and interest secured by a mortgage are "choate liens", for otherwise §6323 (a) would be utterly meaningless.

There is absolutely nothing to distinguish the counsel fee allowed in New Jersey under R.R. 4:55-7 (c) from the interest secured by the mortgage. The interest is stated as a fixed percentage of the unpaid principal balance. Before the mortgagee can receive that sum out of the property, however, the mortgagor must default, a foreclosure action must be commenced, a judgment must be entered that fixes the amount due to the plaintiff and that directs a sale of the mortgaged premises, and the sale must be held and the purchase price received. These are the identical steps that must be taken with respect to the counsel fee. In each case,

the dollar amount will vary only in accordance with the number of payments made by the mortgagor prior to default, and the length of time between default and the entry of judgment (plus additional interest thereon to the date of actual payment to the sheriff).[61]

Despite the contrary contention of the United States, the counsel fee in this case is a far cry from the counsel fee in *Pioneer*. No one can dispute that a "reasonable attorney's fee" is not "fixed in amount". There is no standard by which to measure the dollar value of such a fee, and the allowance is made at the discretion of the court "for services rendered". With this court's declaration that a mortgagee is subject to the "choateness rule", the result of *Pioneer* could not be different. But the basis for the holding must still be, not that the attorney had to render services, but that there was no standard by which to measure, at the time the notice of federal lien was filed, the dollar amount of the lien of the counsel fee. In the present case, however, the lien of the counsel fee, which is not subject to being disallowed or varied in amount at the discretion of the court, could be computed to the penny at any time, merely by determining the number of payments made by the mortgagors and picking a date to which interest is to be computed.

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[61] Thus, for example, the mortgage in the present case was for $30,000, with interest at 6% per annum on the unpaid balances from the date of the loan, December 13, 1960. If no payments were made by the mortgagors, the amount of a judgment for principal and interest computed to December 13, 1961, would be $31,800 ($30,000 principal and $1,800 interest), and the judgment for counsel fee would be $443. (3% of $5,000, or $150; 1½% of $5,000, or $75; and 1% of $21,800, or $218). The only asumptions that had to be made were a date on which the judgment would be entered and the number of payments made by the mortgagors.

The United States complains, however, that this counsel fee in New Jersey is a "'formalistic device' to which the collection of federal revenues may not be subjected," borrowing the descriptive words from *Buffalo Savings Bank*. (Pb5). For more than sixty years, however, New Jersey has had a rule similar to R.R. 4:55-7 (c). In the earlier years, however, the percentages were much lower, in keeping with the economics of the times.[62] It is difficult to understand how a rule such as this, that was in existence prior to the act of Congress, and more than 50 years before this court declared that a mortgagee is subject to the "choateness rule", can be termed a "formalistic device".

The United States also complains that the State of New Jersey can vary the percentages in the Rule. Such a change, however, would be no different than a change in the rate of interest in the mortgage. If the interest rate is changed

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[62] Prior to 1910, the rates were 1% on the first $1,000; ½% on the next $1,000; ¼% on the next $3,000; and 1/5% on the excess over $5,000.

The rule was amended effective February 1, 1910, and again effective January 1, 1917. These rules were identical as to percentages, but the italicized words in the text which follows were omitted in the 1917 amendment. *Rules of the Court of Chancery*, 147. "The percentage, *if any*, to be allowed in uncontested foreclosure cases, pursuant to the chancery act, is hereby prescribed by the Chancellor as follows, viz: on all sums decreed to be paid in such causes amounting to $5,000 or less, at the rate of one per cent; upon the excess over $5,000 and up to $10,000 at the rate of one-half of one per cent; upon the excess over $10,000 and up to $25,000, at the rate of one-quarter of one per cent; and upon the excess over $25,000 at the rate of one-fifth of one per cent: *provided that in cases where the complainant prevails after bona fide litigation a certificate to that effect may be made in the discretion of the Chancellor or Vice-Chancellor, in which case the complainant shall be entitled to double the above-mentioned percentages.*"

after a subsequent lien has attached, the increase may not be effective without the consent of the junior lienholder, but the mortgagee can recover interest at the original rate in any event. The principle involved is no different than that which is involved if the mortgagee makes an additional advance of principal. The mortgagee cannot increase the burden of a junior lienholder without his consent; but if there are no junior lienholders at the time the increase is made, subsequent junior lienholders are subject to whatever rights the prior lienholder had at the times they made their loans.

The United States claims that the distinction between the "reasonable fee" in *Pioneer* and the "precise method for determining the fee" in the present case "is without substance because * * * at the time the tax lien here arose there was no conceivable way of determining what sums or that any sum might some day be 'adjudged to be paid the plaintiff' ". (Pb9). Only by conceding that principal and interest have priority over the tax lien, and then ignoring these items completely, however, is it able to make such a claim. The mortgagee has no rights whatever under the mortgage unless and until the mortgagor has defaulted, a foreclosure action has been commenced, and a court of equity has adjudged what sums are to be paid to the plaintiff. It has no more right to either principal or interest until those sums have been "adjudged to be paid the plaintiff in such [foreclosure] action", (Pb9), than it has to the counsel fee allowed under R.R. 4:55-7 (c).

In making this argument, the United States has failed to give adequate consideration to the reasoning applied by this court in its prior decisions relating to choateness. In the cases that did not involve a mortgagee, pledgee, pur-

chaser, or judgment creditor, Congress had not given priority to the lienholder. Therefore, the only way the lienholder could obtain the protection afforded when Congress required notice to be filed before the lienholder would be affected by a federal tax lien was for him to achieve the status of a judgment creditor.

The mortgagee, however, was given protection in his character as *mortgagee*, and there is no need for him to obtain the status of a *judgment creditor* unless his mortgage, or one or more of his rights, is intrinsically defective or is not fixed in amount, so that as to such right his lien is inchoate.

Finally, the United States complains about the amount of the counsel fee ($425.52) in relation to the amount of the other items of taxed costs, and urges this as a ground for declaring the counsel fee as an "inchoate lien". It might better have objected to the payment of the sheriff's commissions, which were based upon the actual sale price of $41,000. Under New Jersey statutes, the commissions were $1,040, being 4% of the first $1,000 and 2½% of the excess. This amount was computed in the same manner as the interest and the counsel fee, and was subject to every enforcement step required to be taken from the time of default to the actual receipt of the payment by the sheriff.

POINT II

The scope of the protection which Congress has given to mortgagees in 26 U. S. C. §6323 (a) embraces the counsel fee allowed under R.R. 4:55-7 (c) in New Jersey and all other elements of the mortgage lien which, on the date a notice of federal tax lien is filed, can be computed as to amount without making any assumptions other than a date to which interest is to be computed and that if the mortgagor had defaulted, his default was in payment of the item in question, it being immaterial whether or not the mortgagor has actually defaulted.

Since the advent of the "choateness rule" into the non-insolvency federal tax lien cases, mortgagees have been unable to enjoy any of the protection Congress intended to provide in 1913. The reason is that the United States, instead of examining the principles underlying the "choateness rule" when seeking to determine whether a competing lien is choate or inchoate, has chosen to attack specific items *per se*, without examining the characteristics of the particular items, and without regard to the variations in these items that exist because these items are created by state law.

There is no reason for mortgagees to continue to be denied the protection Congress thought it was giving them 53 years ago. If this court, in answering the question presented on this appeal, will define the "choateness rule" in relation to a mortgagee in such a clear-cut manner that there will be a definite standard by which all elements of a mortgage, and hence all rights of a mortgagee, can be judged, it will be possible to achieve this result.

In formulating the definition, it is important to make clear first that a mortgage lien includes all rights of the mortgagee—principal, interest, advancements made pursuant to the terms of the mortgage, and all costs and fees involved in the foreclosure proceedings, because the federal tax lien is not rendered invalid as to mortgagees, as Congress has declared it to be, to the extent that any right of the mortgagee is denied priority.

After the mortgage lien has been defined as embracing every right of the mortgagee, the definition of "choateness" suggested below can be applied to each right independently to determine whether or not it is entitled to priority. Respondents suggest the following definition:

> If the amount of the item in question can be determined at the moment the notice of federal tax lien is filed, without making any assumptions other than (1) a date to which interest is to be computed, and (2) that if the mortgagor had defaulted, his default was in payment of the item in question, that item constitutes a "choate lien" and is entitled to priority over the federal tax lien, it being immaterial whether or not the mortgagor has actually defaulted.

Let us test the suggested definition.

Principal. All that is needed is a factual determination of the amount or amounts loaned to the mortgagor and the total payments on account of principal received by the mortgagee. The lien is choate.

Interest. All that is needed is a factual determination of the amount of unpaid principal and interest, plus the assumption of a date to which interest is to be computed. The lien is choate.

Counsel fee. In New Jersey, and in any other state having a similar statute or rule, in which the counsel fee is stated in fixed percentages and the allowance is mandatory rather than discretionary, all that is needed is a factual determination of the amounts of unpaid principal and interest, plus the assumption of a date to which interest is to be computed. The lien is choate.

In Arkansas, and in any state in which the counsel fee is stated in terms of reasonableness, or is allowed in the discretion of the court, the amount cannot be determined, and the lien is inchoate.

Other Costs of the Foreclosure Action. These items are usually provided by statute or court rule. Once it is known that a foreclosure action is to be commenced, they can be computed if all the facts are obtainable. Therefore, all that is needed is a factual determination of the rights of others to which the property is subject and the costs can then be computed. The lien of such costs is choate.

Advancements for Fire Insurance. All that is needed is the assumption that the mortgagor had defaulted in payment of the fire insurance premium, in which case the amount to be advanced can be computed.[63] The lien is choate.

Advancements for Necessary Repairs. All that is needed is the assumption that the mortgagor had defaulted in mak-

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[63] Despite the fact that fire insurance premiums normally are not too large, and, if they are not paid the security for all liens, including the federal tax lien, is put in jeopardy, respondents' attorneys have been unable to obtain any assurance that the United States would not contest the priority of a fire insurance advance if the amount involved should be substantial.

ing necessary repairs, in which case the cost of the repairs can be determined. The lien is choate.

Advancements for Municipal Taxes.

a) Prior to the filing of the notice of the federal tax lien.

In its answer in the present case, and in all such cases known to respondents, the United States has ignored the Congressional act requiring notice in order to affect mortgagees, and has contested the validity of any advancements whatever after the assessment dates of the federal liens (Tr. 4). There is no basis for such a dispute, because the sums advanced have been made a part of the mortgage lien, and the identity of person, property, and amount are all known at the time the notice is filed. The lien is choate.

b) After the filing of the note of the federal tax lien.

Mortgages are given subject to a provision of state law that gives priority over all other state-created liens, including mortgages, to local tax, water, and sewer liens. Thus, even without the intervention of a federal tax lien, the value of the security held by the mortgagee is reduced to the extent of the unpaid local taxes and water and sewer rents. If the mortgagee has not seen fit to advance these delinquent items and make them a part of his mortgage, as provided in the mortgage, prior to the time a notice of federal tax lien is filed, there is no reason why he should receive the property free and clear of them if a federal tax lien has arisen, unless these items themselves are choate liens entitled to priority over the federal tax lien. In giving protection to the mortgagee, Congress did not intend to give the mortgagee more rights than he would have had if there had been no federal tax lien.

However, if, as in *New Britain*, there are some municipal liens that are entitled to priority over the federal tax lien, even in the hands of the municipality, there is no reason why a mortgagee whose lien also is entitled to priority over the federal tax lien should be denied the right to advance those taxes and retain priority, not only for its original mortgage, but also for the amount of such taxes added thereto, irrespective of when the mortgagee makes the advancement.

The principle is no different from that recognized by the United States in this case with respect to the first and second mortgages. As set forth in its brief (RA2a) it concedes that where there are two or more liens entitled to priority over the federal tax lien, the proper manner of setting up the rights of the parties is to establish a priority adjustment fund to be distributed according to state law, equal to the total of the sums due to each prior lienholder. Once the fund is set up, the United States concedes that it has no interest in the distribution of the fund. Therefore, if the second mortgagee wishes to advance the amount due to the first mortgagee, he would be able to claim the total funds due on both the first and second mortgages. So it is with a mortgagee who advances municipal taxes that have priority over the federal tax lien because they were assessed and became choate prior to the assessment of the federal taxes. Both the mortgage and the municipal tax liens have priority over the federal tax lien, and it is of no concern to the United States whether the municipality or the mortgagee is entitled to obtain payment out of the property. Under no circumstances, however, could the mortgagee advance taxes such as those in *Buffalo Savings Bank*, and obtain priority.

Thus, in the case of municipal liens that had not been advanced prior to the filing of the notice of the federal tax lien, the mortgagee could advance them and have a choate lien only if they had been assessed and had become choate prior to the time the assessment of the federal taxes was made. Priority would depend upon whether or not the municipality had a choate or an inchoate lien at the time of assessment of the federal taxes rather than at the time of filing of the notice of the federal tax lien. The mortgagee can protect himself by determining in advance whether or not the municipal taxes being advanced are choate or inchoate. If they are inchoate, he can proceed to immediate foreclosure in order to minimize the amount of taxes that will arise during the enforcement procedure.

Increase in rates of interest and percentages used in computing counsel fees and sheriff's fees. These items are essentially the same as advancements of principal. If the increase in rates was made before notice of a federal tax lien has been filed, the increased amounts would be choate liens; but if the increase in rates was made after the notice has been filed, the increased amounts would be inchoate liens.

* * *

The definition should go one step further and make clear that the "choateness rule" depends upon the existence of a federal *tax* lien. We have printed a portion of our trial court brief which refers to an answer filed in an action that involved a junior mortgage lien held by the United States of America acting through the Farmers Home Administration, in which the answer filed by the United States was identical to that filed in the tax lien cases (RA1a). On a motion for summary judgment, plaintiff prevailed, the court holding first that it believed the lien of the New Jersey

counsel fee to be choate, and second that it believed that the choateness rule was applicable only in tax lien cases. The United States took an appeal, and the parties contemplated bringing both appeals to this court at the same time. Prior to filing its brief, however, the plaintiff was advised that the solicitor general had ordered the appeal to be dropped.

In *Security Trust*, when this court first applied the "choateness rule" to a tax lien case, it said of the choateness rule that had theretofore been applied only in insolvency cases:

> "If the purpose of the federal tax lien statute to insure prompt and certain collection of taxes due from tax delinquents is to be fulfilled, a similar rule must prevail here."[64]

No such reason exists for imposing the "choateness rule" in a case in which the United States is the holder of a junior mortgage. In *New Britain*, this court recognized the "cardinal rule" that "a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a Court of law or equity to a subsequent claimant."[65] It should be made clear that this is the only rule to be applied in non-tax lien cases, unless Congress has specifically provided for some other rule.

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[64] 340 U. S. at 51, 95 L. Ed at 57.

[65] 347 U. S. at 85 and 86, 98 L. Ed. at 526.

CONCLUSION

The mortgagees in this case seek a ruling on the counsel fee in New Jersey foreclosure actions that is based upon *a principle* that can be applied to every right held by a mortgagee, stated in such clear terms that reasonable men cannot differ as to the results. They earnestly implore this court to relieve them, and all mortgagees, of the burden that has been thrust upon them because of the lack of an adequate definition of the "choateness rule" as it applies, not to municipal tax liens, landlords, or mechanics lien claimants, to whom Congress did not give protection from unrecorded federal liens, but to mortgagees, to whom Congress did give protection.

The definition suggested by the mortgagees in this case would put an end to the controversy between the United States and mortgagees. Its adoption would again restore to the mortgagees the protection which Congress intended to give them in 1913.

Respectfully submitted,

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FRANK W. HOAK,
Of Counsel and
on the Brief.

April 5, 1966.

APPENDIX

Excerpt from Page 5 of Brief and Appendix for Plaintiff-Appellant

SUPERIOR COURT OF NEW JERSEY
APPELLATE DIVISION—DOCKET NO. A-723-63

PRELIMINARY STATEMENT

The question presented by this appeal is narrow in scope, and involves the sum of $425.52. The matter is of great practical significance, however, because the question is raised in several hundred cases per year—every time a mortgage is foreclosed on property affected by a federal tax lien.[1]

* * *

[1] During the preparation of this brief, plaintiff has been served with an answer to a foreclosure complaint in which the United States, joined as the holder of a mortgage, granted by the Farmers Home Administration and subsequent in time to both the plaintiff's mortgage and to a judgment against the mortgagors, has disputed the allowance of counsel fees and advancements. Thus, the United States has expanded its contentions to include any lien held by the United States.

Excerpt from Page 5 of Brief for United States of America, Defendant-Respondent

* * * It is however, recognized that under state law, the first mortgagee's claim for an attorney's fee is superior to the second mortgage. The resolution of this problem of circular priorities as established by the foregoing decisions is to provide for a priority adjustment fund in the amount of the principal and interest, plus costs, of the two prior mortgages under the federal order of priority. This amount is to be first set aside out of the proceeds of sale, but any excess over the priority adjustment fund must be first applied to satisfaction in full of the federal tax lien.* Once the priority adjustment fund is established, the Government has no interest in its distribution.

(* The question concerning the excess over the priority adjustment fund has never been decided in this case because it affects only the respondent second mortgagee, who has never been denied full recovery, and who would be denied full recovery only if this court should hold the lien of the counsel fee to be inchoate.)